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COORDINATED ISSUE
FOREST PRODUCTS INDUSTRY
LOGGING ROADS - DEPRECIATION AND INVESTMENT TAX CREDIT

ISSUE

What portion, if any, of the cost incurred by the taxpayer in constructing logging roads on its own land, should be considered as a non-depreciable cost and therefore not subject to either a deduction for depreciation under IRC 167(a) or the investment credit under IRC 48(a)?

BACKGROUND, LAW, AND ANALYSIS

Many taxpayers disagree with the assumption made in Rev. Rul. 68-28l, l968-l C.B. 22, that "the cost of clearing, grubbing and rough cut and fill (grading) of (a permanent road)" is non-depreciable. They argue that this assumption was advanced during a time frame in which the Internal Revenue Service was maintaining a position that costs of dirt moving and earthwork "inextricably associated with the land" was an investment in intangible property and was non-depreciable. Case law and rulings (subsequent to 1965) demonstrate that this position has been overturned.

Taxpayers also argue that while the useful life of logging roads cannot be measured precisely, the lives can be determined with sufficient precision to fully satisfy Regs. l.l67(a)-l(b).

Revenue Ruling 65-265, 1965-2, C.B. 52, provides that: "The cost of general grading of land is a part of the cost base of the land and is non-depreciable. The grading of land involves moving soil for the purpose of changing the ground surface. It produces a more level surface and generally provides an improvement which adds value to the land. Such expenditures are inextricably associated with the land and, therefore, fall within the rule that land is a non-depreciable asset."

Revenue Ruling 68-28l affirms that a taxpayer’s logging truck roads are "Section 38 Property" for investment credit purposes. Also, that the "cost of clearing, grubbing, and roughcut and fill (grading) of the road is placed in a non-depreciable account. The cost of the depreciable portion of a ’permanent’ road (such as bridges, culverts, graveling, and paving) is normally recovered by the taxpayer through one of the methods of depreciation under Section 167(b) of the Code." The non-depreciable portion, of course, is not eligible for investment credit.

Rev. Rul. 68-281 outlines the difference between "permanent" and "temporary" roads and the tax treatment allowed for each. Generally, a permanent road remains useful for a longer period of time while a temporary road is constructed and used for a very limited specific purpose and is then abandoned. The permanent roads will be used after logging for planting, fire control, future management, thinning, and possible other uses of the forest. After logging and regeneration crews are finished, the roads may be used only periodically and maintained may be performed only as anticipated need dictates but the need and use of the road is of an indefinite period of time.

Rev. Rul. 88-99, 1988-2 C.B. 33, clarifies Rev. Rul. 68-281 by pointing out that the physical characteristics of a road are not determinative as to whether the roadbed is depreciable or amortizable. To be depreciable or amortizable, the property must have a useful life to the taxpayer that is determinable. The fact that a logging truck road is not a high-specification, mainline-type road is not determinative of whether its roadbed has a determinable useful life to the taxpayer.

SERVICE POSITION

Whether a logging road has a determinable useful life versus an indefinite useful life is the key to the issue and a question of fact. Terminology used to describe the road such as the terminology used in Rev. Rul. 68-281 is not the determining factor.

The logging road is integral to the production of timber and serves the forest which has a perpetual, indeterminate life. It is incorrect to link the life of the logging road to the life of the mill which the forest supplies.

A good discussion of the issue is contained in a l979 Tax Court case, Wolfsen Land and Cattle Company, 72 TC l. Although the case deals with canals and ditches, the issue is identical to logging roads.

The current position of the Service can be illustrated by the following:

The taxpayer is engaged in the business of growing and harvesting commercial timber on land it owns in fee. Some of the timber land is in the Southeast and is cut as early as 30 years after planting with commercial thinnings as early as l5 years. Other lands in the West have growing cycles as long as 60 years. The taxpayer’s permanent mainline road system has been in place for many years. Various public roads also serve this purpose.

Situation l.
The taxpayer builds a road on its own land to harvest a small block of timber. After harvest and replanting the block, the road is abandoned. No maintenance is performed and in some cases culverts are removed and access to the road is blocked by

construction of a large ditch across the entrance of the road. Due to a combination of environmental factors including soil conditions, drainage, terrain characteristics, vegetation, and the length of time between harvests, it is expected that a new road will be required for the next harvest. While some portion of the old road right-of-way may be utilized for the new road, any cost savings due to the existence of the old road would be negligible.

No portion of the cost of this road should be capitalized to non-depreciable land improvement account.

Situation 2.
Same facts as Situation l except that the environmental factors, original road quality, and harvest cycle are such that it is expected that the old road will be repaired and utilized for the next harvest.

The cost of engineering, clearing, grubbing, and grading has an indefinite useful life and should be placed in a non-depreciable account. The cost of surfacing and culverts should be placed in a depreciable account as should the cost of reclamation when the road is prepared for the next harvest.

Situation 3.
Same facts as Situation l except that a portion of the road is constructed across the face of a steep slope. This portion of the road requires extensive drilling and blasting of rock to create a notch or cut across the face of the slope. Upon the next harvest, a new road will be constructed but the cost for this portion will be substantially less since it can utilize the existing cut.

The cost of the drilling and blasting is a permanent land improvement and should be placed in a non-depreciable account.